DEPARTMENT OF STATE REVENUE

LETTER OF FINDINGS NUMBER: 99-0445
CORPORATE INCOME TAX
FOR TAX PERIODS: 1994-1997

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ISSUES

1. Adjusted Gross Income Tax-Addback of Property Taxes

Authority: IC 6-3-1-3.5 (b).

Taxpayer protests the add-back of property taxes.

2. Adjusted Gross Income Tax- Net Operating Loss

Authority: IC 6-3-2-2.6.

Taxpayer protests the calculation of net operating loss deduction.

Statement of Facts

Taxpayer is a manufacturer of automobiles. After an audit for the tax period 1994-1997, Taxpayer was assessed additional adjusted gross income and supplemental net income taxes. Taxpayer timely protested the assessments and a hearing was held. Further facts will be presented as necessary.

1. Adjusted Gross Income Tax- Addback of Property Taxes

Discussion

Taxpayer's first protest concerns the add back of property taxes. For taxable year 1994, Taxpayer filed an amended Indiana income tax return to modify the calculation of its adjusted gross income IC 6-3-1-3.5 (b) as follows:

In the case of corporations, the same as "taxable income" (as defined in Section 63 of the Internal Revenue Code) adjusted as follows:

(1) Subtract income that is exempt from taxation under IC 6-3 by the Constitution and statutes of the United States.
(2) Add an amount equal to any deduction or deductions allowed or allowable pursuant to Section 170 of the Internal Revenue Code.
(3) Add an amount equal to any deduction or deductions allowed or allowable pursuant to Section 63 of the Internal Revenue Code for taxes based on or measured by income and levied at the state level by any state of the United States or for taxes on property levied by any subdivision of any state of the United States.
(4) Subtract an amount equal to the amount included in the corporation's taxable income under Section 78 of the Internal Revenue Code.

Taxpayer amended its 1994 return to change the amount reflected as an add back of property taxes by not adding back the amount of property taxes which were classified for federal purposes as costs of goods sold. Taxpayer also did not add back those property taxes in its Indiana income tax returns for 1995-1996.

Taxpayer argues that the property taxes which are a component of costs of goods sold should not be added back since they are not deductions allowed pursuant to Section 63 of the Internal Revenue Code as follows.

> (a) In General. – Except as provided in subsection (b), for purposes of this subtitle, the term "taxable income" means gross income minus the deductions allowed by this chapter (other than the standard deduction).

The capitalized property taxes, as part of the cost of goods sold, are deducted from Taxpayer's total receipts in determining Taxpayer's gross income. Therefore they are included in the gross income. When deductions are taken from the gross income to determine the "taxable income" as defined by this statute, the inclusion of the deductions in the gross income effectively includes those deductions in the term "taxable income" as defined by this statute.

Taxpayer contends that it does not have to add back property taxes because they are defined as nondeductible from "taxable income" as defined by the statute pursuant to the following provisions of Section 263 A as follows:

(a) Nondeductibility of Certain Direct and Indirect Costs.
(1) In general. –In the case of any property to which this section applies, any costs described in paragraph (2)—
(A) in the case of property which is inventory in the hands of the taxpayer, shall be included in inventory costs, and
(B) in the case of any other property, shall be capitalized.
(2) Allocable costs. – The costs described in this paragraph with respect to any property are-
(A) the direct costs of such property, and

(B) such property's proper share of those indirect costs (including taxes) part or all of which are allocable to such property.

> Any cost which (but for this subsection) could not be taken into account in computing taxable income for any taxable year shall not be treated as a cost described in this paragraph.

Taxpayer is correct in that this provision does not allow a deduction of the property taxes after the determination of "taxable income" as defined by this statute. That does not negate the fact, however, that the property taxes were deducted in the determination of the gross income portion of the formula for determination of the "taxable income" as defined by the statute. Therefore the property taxes were effectively deducted and must be added back.

Finding

Taxpayer's protest is denied.

2. Adjusted Gross Income Tax- Net Operating Loss

Discussion

Taxpayer's second point of protest concerns the calculation and application of net operating losses. Net operating losses are calculated pursuant to the method set out in IC 6-3-2-2.6. The first step is determining the amount of federal net operating losses. The larger of the federal net operating loss and zero is determined. Indiana net operating losses are calculated by determining the amount of federal net operating losses attributable to revenue sources within Indiana. Those losses are deducted from the Indiana income. 45 IAC 3.1-1-9 provides an example of the calculation and application of corporate net operating losses. The Auditor followed this example and calculated the Indiana net operating losses correctly in determining the amount of tax owed by Taxpayer.

Taxpayer contends that the audit applied the net operating loss incorrectly by applying Indiana modifications in the year the loss was incurred and in every other year in which the net operating loss was used. Application of the net operating loss is clarified at 45 IAC 3.1-1-9 as follows:

> The net operating loss as described in Internal Revenue Code Sec. 172 is an allowable deduction for corporations in computing Indiana Adjusted gross Income. The amount of the loss which may be deducted is the Federal net operating loss after:
>
> (1) All modifications required under IC 6-3-1-3.5 (b); . . .

Under this Regulation, Indiana modifications are used to compute the Indiana adjusted gross income in the year of utilization of a net operating loss, prior to application of the loss. The loss is then to be adjusted in each year of utilization of the loss by the Indiana modifications of the year of the utilization of the net operating loss.

Finding

Taxpayer's second point of protest is denied.

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